Opinion: Poly Medicure Ltd

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Business Background

Poly Medicure Limited was incorporated in 1995 and is promoted by the Baid Family. While the founder, Mr. Juggal Kishore Baid is a non-executive director, Mr. Rishi Baid is an executive director and Mr. Himanshu Baid is the Managing Director of the company.

The Board is chaired by Mr. D R Metha, a retired IAS Officer, who held the position of SEBI Chairman and Dy. Governor of RBI in the past.

The company is involved in the manufacture and distribution of disposable medical equipment such as intravenous cannulae, blood bags, catheters and around 100 other products. The company has two factories in HSIDC Industrial Area, Faridabad and one in Haridwar, Uttrakhand. A new factory is under construction in Jaipur, Rajhashtan.

Poly Medicure Limited has innovated the 'Safety IV Cannulae', a product which opened doors to developed markets such as the US. Additionally, it defended a patent infringement suit brought on by market leader B. Braun successfully.

Highlights

- Out of the total revenues of over Rs. 260 Cr (FY-13), nearly 43% was generated from the sale of IV Cannula, (compared to 45% last year) and around 9% was generated from sale of Blood Bags (same percentage share as last year). These two products have been the most successful segments for the company over the years.
- Geographically, 59% of the revenue was earned from exports and the rest from the domestic market. For the FY-13, the company's major markets were Europe and South America.
- CAGR of revenue for the past 5 years is 24% and CAGR of 5-Year Net Profit is 25%.
- Dividend yield is generally low at around 0.8%; and the payout ranges between 16-19%.
- Approximate capex in the recent years (FY11-14) is Rs. 100 Cr, increasing the net block from Rs. 70 Cr in FY-11 to Rs. 92 Cr in FY-13. With the factories expected to come online during this year, the gross block is set to increase further.
- Out of the total capex, around Rs. 50 Cr. has been borrowed and the rest was funded through internal accruals. The Financial Leverage has been stable at around 2.0 over the years.
- The company is currently building a new factory in Jaipur Special Economic Zone, Rajhasthan to expand its production capacity. Furthermore, they plan to automate current factories to ease their dependence on labor.
- The company has a couple of foreign subsidiaries through which it performs different activities. The subsidiary in China is mainly used for sourcing raw material from nearby areas at low prices and the subsidiary in US is primarily meant for marketing purposes.
- The JV in Egypt is into consultancy as well as selling products manufactured by the company.
- Cost of raw materials is around 35% of the sales and out of the total, nearly 75% is imported. These include crude derivatives such as Plastic granules, PVC Sheet and SS Tube.

Shareholding Pattern

Holder	Percentage Share
Promoters	48.7
Bodies Corporate	34.37
Indian Public	16.03
Others	0.9

Select Financial Data

Measure	FY-13	FY-12	FY-11	FY-10
Net Sales (Rs. Cr)	260	217	173	137
Net Profit (Rs. Cr)	23.2	19.2	21.1	15.2
NPM (%)	9.0	8.9	12.2	11.1
Financial Leverage	1.9	1.9	2.0	2.2
Asset Turnover	1.3	1.3	1.2	1.2
ROE (%)	22.6	22.4	30.7	28.1
CFO (Rs. Cr)	33.0	22.5	21.2	13.6
BVPS*	51.1	42.4	35.4	27.5
EPS*	11.0	8.7	9.6	6.9

*Adjusted For Bonus

Risks/Negatives

- The company's shareholders include 'Bodies Corporate' which together hold a little more than 34%. These corporations are promoted by individuals close to the promoter group of Poly Medicure and have been long term investors in the company. The possible exit of these investors (since they are sitting on huge potential profits) and the information advantage that they might have (due to the close relationship with the promoters) is a cause for concern.
- The stock of the company is relatively illiquid, hence leading to a significant spread. This is probably one of the reasons why the stock is not held by any mutual fund (as on 31st June 2013).
- The company does not provide as much data as we would like with respect to the production capacities, capacity utilization, etc. Furthermore, there is very minimal analyst coverage and is rarely featured in the news.
- It has strong competitors in the cannulae segment, both internationally and in the domestic market. Hindustan Syringes & Medical Devices is the market leader domestically and German major B. Braun is the market leader internationally. However, Poly Medicure is the relative new-comer and plans on taking business away from the incumbent players.
- The company's raw materials are derivatives of crude oil and are primarily imported. With the recent increase in the crude oil prices and the depreciation of the Indian Rupee, the cost of raw materials is likely to go up for the company in the coming quarters.
- There is a need of constant innovation if the company wants to keep growing at the current levels of 20-25%. Even though the expenditure on R&D has increased over the past years, there is always a risk that the new products may not be as rewarding as initially expected.
- The company has seen a steady rise in the 'accounts receivables'; sundry debtors now form a little over 20% of the assets, up from 17.5% two years back. This suggests that the quality of earnings is declining, but is still far away from becoming a roadblock for the investor.
- Around 75% of the debt taken by the company is in foreign currency. Even though the interest rate on these loans is low (5%), the company is exposed to the currency rate fluctuations. However, this would be mitigated due to foreign currency earnings of the company.
- The company is currently selling at a Price to Book Value of 4.25, which according to us is slightly on the higher side. Since a lot of growth is already priced in, if the company has a rough quarter or two (due to whatever reasons), the stock may take a significant beating.

Valuation

We have taken into account the principal payment on the loans taken by the company, the (sustainable) improved margins and the growth expected from new segments.

We believe that the intrinsic value of equity is Rs. 652 Cr and a target price of 300 is achievable. From a current market price of 230, this represents a return of 30%.

The company is currently selling at an earnings multiple of 16.7 and a price to book value of 4.25.

Year	FY14	FY15	FY16	FY17	FY18
Sales	325	396	483	580	667
PAT	44	53	65	78	90
FCFE	23	38	75	32	90

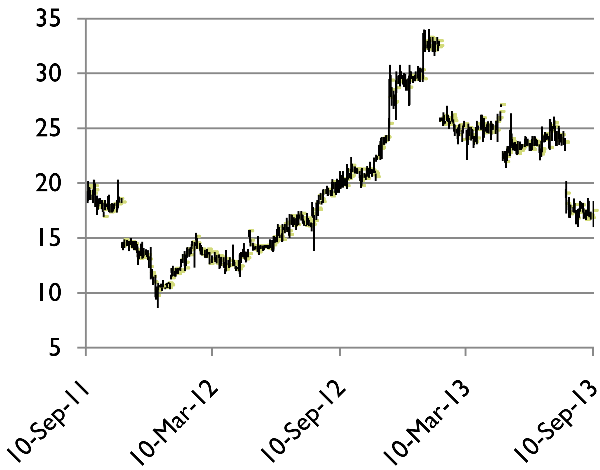
Investment Rationale

- Poly Medicure Limited has strong fundamentals with consistently attractive ROE and margins.
- The company operates in a defensive industry which is relatively immune to the slowdown or recession faced by countries around the globe.
- Around 60% of the company's revenues are derived from exports and it earns more than it spends in foreign currency. Hence it is set to gain from the weak Indian Rupee.
- The company has done gone through a phase of backward integration wherein the needles required for manufacturing of their main product (IV Cannula) were initially imported; now they make their own needles at 25% of the cost.
- Poly Medicure has successfully defended the patent infringement suit filed by B. Braun and hence they can continue supplying to the United States. Chances of future complications are now, low. Furthermore, margins should increase since litigation expenses were incurred in past years.
- The company had undertaken multi-year hedging contracts prior to 2008 crisis. They were facing significant losses on these contracts till they expired in Oct-12. Since then, they have been able to save around 6-8% of the total costs, adding directly to the bottom line.
- Due to the disposable nature of the products, clients have to keep coming back for more.
- One of the factories in Faridabad is approved by USFDA, meaning the company will not have much trouble in exporting their products to the developed markets. Furthermore, since it is an Export Oriented Unit, it helps the company in receiving export incentives from the Indian Government.
- They plan to add the safety feature to other equipments and then sell a basket of products to the United States, which can be a significant growth driver in the future. Furthermore, the sale of products to these markets offers better margins and the company expects the share of these products to increase in the future. Hence, the company may see a trend of improving margins in the future.

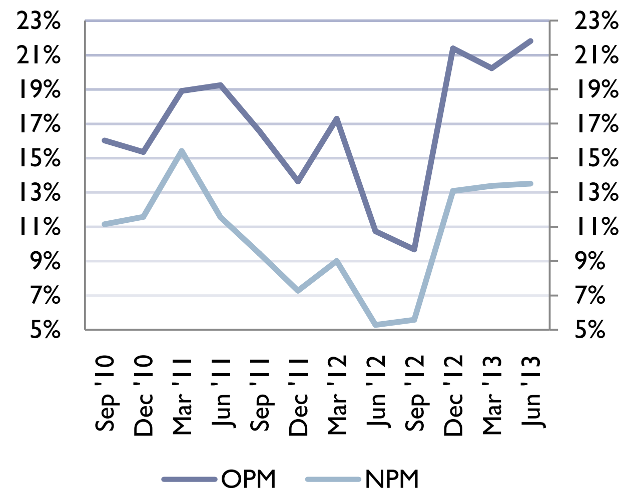
Conclusion

Poly Medicure Limited has started exporting the Safety IV Cannula to the United States and is expected to receive more orders in the near future. The profitability is set to improve further because this is a high margin segment and due to the end of non-recurring expenses incurred in the past 2-3 years. The company is building new factories to support the growth and upgrading current ones to improve quality and efficiency. The balance sheet is healthy with D/E slightly below 0.35; the company makes Cash in excess of the net profit and the management is well qualified and ethical.

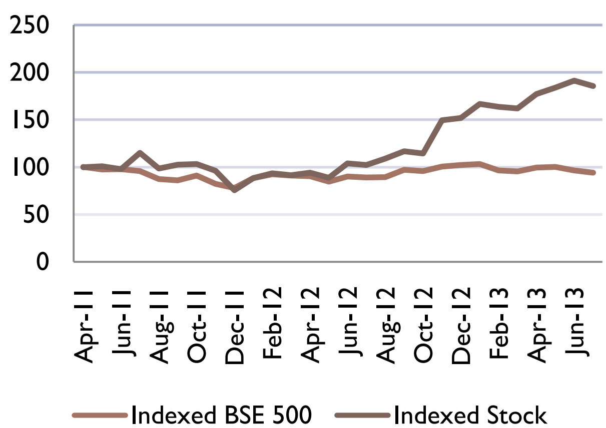
P/E Ratio Band



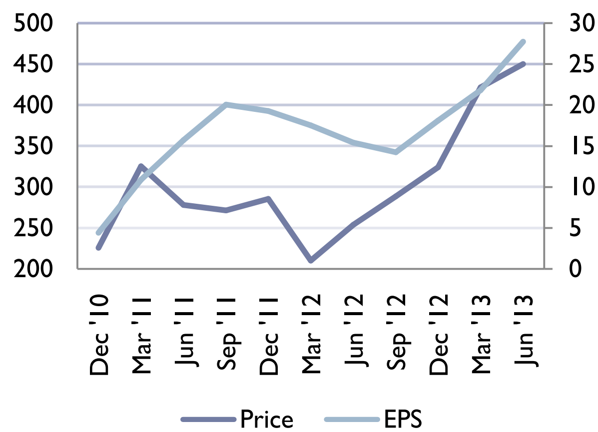
Operating and Net Profit Margins



Price Movement of Poly Medicure v/s Index



Price Movement v/s EPS (unadjusted)



Note: The Company and the Analyst may have a position in the stock from time to time.

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